(16)



No. 97-1287

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1998

HUGHES AIRCRAFT COMPANY, ET AL.,

*Petitioners*,

v.

STANLEY I. JACOBSON, ET AL.,

*Respondents*.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

# BRIEF OF THE ERISA INDUSTRY COMMITTEE AND THE NATIONAL ASSOCIATION OF MANUFACTURERS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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July 2, 1998

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## INTERESTS OF AMICI CURIAE

*Amici* are associations whose members maintain pension and other employee benefit plans governed by the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.*[1]

[1] Letters from petitioners and respondents indicating consent to file this brief are on file with the Clerk. Pursuant to Rule 37.6, *amici* state that no counsel for any petitioner or respondent authored this brief in whole or in part. No person or entity, other than *amici curiae* and their members, made a monetary contribution to the preparation or submission of this brief.

The ERISA Industry Committee ("ERIC") is a nonprofit organization representing America's largest employers that maintain ERISA-covered pension and other employee benefit plans providing benefits to millions of active and retired workers nationwide.

The NAM is the nation's oldest and largest broad-based industrial trade association; its nearly 14,000 member companies and subsidiaries, including 10,000 small manufacturers, employ approximately 85 percent of all manufacturing workers and produce over 80 percent of the nation's manufactured goods. More than 158,000 additional businesses are affiliated with the NAM through its Associations Council and National Industrial Council. Virtually all of the NAM's members maintain one or more employee benefit plans governed by ERISA.

Both ERIC and the NAM frequently participate as *amici* in cases with the potential for far-reaching effects on employee benefit plan design or administration. ERIC previously filed a brief *amicus curiae* in support of the petition for writ of certiorari in this case.

*Amici* have a strong interest in the issue presented by this case, which could be extremely detrimental to both employers and employees who participate in ERISA-covered plans that have or have had an employee contribution feature. If the opinion of the Court of Appeals is upheld, employers that sponsor such plans will face major deterrents to amending their plans to offer new or enhanced benefits to active employees, and many employees now and in the future will be denied the opportunity to enjoy such benefit improvements. Moreover, employers that have already made such amendments could face similar litigation seeking "in effect" to terminate the plan in a manner that will generate unintended windfalls for some retirees while compromising the employer's ability to provide pension benefits to current and future employees.



Because of the importance of these issues to *amici* and their members, they submit this brief to assist the Court in its resolution of the case.

## STATEMENT

This case involves a challenge to two amendments to Petitioner Hughes Aircraft Company's ("Hughes") Non-Bargaining Retirement Plan (the "Hughes Plan"), an ERISA-covered plan. Respondents are five retired employees who are participants in the Plan. They purport to represent "a class consisting of all participants of the Plan who are or may become eligible to receive retirement benefits under the Plan." Pet. App. 133a.

The Hughes Plan is a single-employer "defined benefit" plan. A defined benefit plan is one in which the employee, upon retirement, is entitled to a fixed periodic payment calculated in accordance with the terms of the plan, regardless of the performance of the plan's assets. *Nachman Corp. v. Pension Benefit Guaranty Corp.*; 446 U.S. 359 (1980); *see also Commissioner v. Keystone Consolidated Industries*, 508 U.S. 152, 154 (1993). If unsuccessful investment impairs the plan's ability to pay the defined benefits from plan assets, the employer must make up any deficiency from its own assets. *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 230 (1986) (O'Connor, J., concurring). In a defined benefit plan, accordingly, the risk of investment gain or loss lies with the employer-sponsor rather than with the employee-participant.[2]

[2] A defined benefit plan such as the Hughes Plan stands in contrast to a defined contribution plan. In a defined contribution plan, a participant's benefits are based upon the sum of the contributions to the plan made by him or by the employer on his account, plus any forfeitures allocated to his account, together with the gains or losses attributable to those contributions and forfeitures. 29 U.S.C. § 1002(34). In a defined contribution plan the risk of investment gain or loss lies entirely with the employee. *Nachman*, 446 U.S. at 364 n.5.

Some defined benefit plans, including the Hughes Plan, require or formerly required employees to contribute to the funding of the plan. *See Malia v. General Electric Co.*, 23 F.3d 828, 830 n.2 (3d Cir. 1994). The difference between a contributory and noncontributory defined benefit plan is in many respects more a difference of form rather than substance.[3] In both cases, the employer-sponsor is ultimately responsible for paying retirees the defined benefit.

Respondents' complaint alleges that by the end of 1985, the Hughes Plan "had accumulated a substantial overfunding" amounting to roughly $1 billion and that from 1986 to 1990 Hughes was not required to make any contributions to the Plan, although employees continued to contribute. Pet. App. 137a.

Respondents contend that Hughes diverted the Plan "surplus" for its own benefit, and violated its fiduciary duties to retirees by adopting two amendments to the Hughes Plan. Pet. App. 139a-140a. One amendment, adopted in 1989, added special early retirement incentives that, by definition, were not available to retirees. Pet. App. 137a-138a. The other amendment, effective January 1, 1991, gave existing Plan participants who were still active employees the option of continuing to make contributions to the Plan or ceasing them (which would give them a correspondingly lower pension benefit upon retirement), and eliminated the contributory feature altogether for new employees. *Id.*

Plan amendments such as those challenged by respondents are not at all uncommon. ERIC and NAM separately surveyed their members, and a total of 57 large employers, sponsoring a total of

[3] When an employer eliminates an employee contributory feature, the employer's total compensation costs (cash wages plus employer payments for benefits) increase in the absence of either a reduction in wages or in the cost of benefits. Because employers are generally sensitive to total compensation costs, that increase in costs is likely to inhibit increases in other components of total compensation.



244 defined benefit plans, responded.[4] The surveys indicate that 86 of those 244 plans (35%) had been amended at one time or another to add or enhance an early retirement feature, and 151 plans (62%) had been amended to add a new or different benefit or benefit formula limited to participants who had not yet retired. Furthermore, while defined benefit plans that have or have had a contributory feature represent only a minority of all defined benefit plans, it is a significant minority. ERIC's and the NAM's surveys showed that 96 of 244 plans responding currently have or have had contributory features, or were merged with or spun-off from plans that had such features.

In addition to alleging that the 1989 and 1991 amendments constituted an unlawful use of Plan assets, respondents also contend that the Hughes Plan was "constructively" terminated when its contributory feature was amended, and that "excess" plan assets should therefore be distributed to them. Pet. App. 140a-142a.

The District Court dismissed the complaint for failure to state a claim for which relief can be granted. Pet. App. 63a. The Ninth Circuit reversed in a divided opinion. Pet. App. 1a. This Court granted the petition for certiorari on April 27, 1998.

## SUMMARY OF ARGUMENT

Were it not for the contributory feature of the Hughes plan, the breach of fiduciary duty claims in this case would clearly be disposed of on the basis of *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996). There, as here, the gist of the complaint was that the addition of an early retirement program (which benefits the employer by helping to reduce its workforce) was a conversion or use of plan assets for the benefit of the employer. There, as here,

[4] Many companies sponsor different defined benefit plans for participants who work or who prior to retirement worked in different job classifications (such as hourly wage earners and salaried employees) or in different units or divisions of the company.

the answer is that adding benefits and beneficiaries are the functions of plan settlors, not fiduciaries, so that fiduciary obligations—including the duty to administer the plan solely for the benefit and in the interest of participants—simply do not come into play.

In this case, the Ninth Circuit panel majority attempted to distinguish *Lockheed* solely on the basis of the contributory feature of the Hughes Plan. That distinction does not withstand analysis, and accordingly the decision below should be reversed.

On the fiduciary duties issue, it was error for the panel majority to treat the so-called plan "surplus" attributable to employee contributions as a distinct asset for which Hughes as Plan sponsor has special fiduciary responsibility and in which Plan participants enjoy something akin to an ownership interest. Whether a plan is contributory or noncontributory, a participating employee's only claim in a defined benefit plan is to the fixed benefit that has been promised by the terms of the plan. The only significance of the plan being contributory relates to the vesting, or nonforfeitability, of those fixed benefits, and to the disposition of the plan's assets upon "termination" within the meaning of the statute. An employee who made contributions to a defined benefit plan has no ownership interest in the "surplus" of an ongoing plan, and the contributory feature does not transform the settlor's decisions into the acts of an ERISA fiduciary when those decisions otherwise would fall outside the statute's definition of fiduciary activities.

The Ninth Circuit panel majority also erred in holding that the question whether a plan has been terminated presents an issue of fact to be resolved after discovery. The exclusive means of terminating a defined benefit plan is found in ERISA Section 4041, 29 U.S.C. § 1341. Where no plan termination within the meaning of Section 4041 has occurred, employees cannot assert any right to residual assets under Section 4044, 29 U.S.C. § 1344. The Hughes Plan is an ongoing plan that has not terminated under Section 4041,



and that is sufficient to require dismissal of the respondent retirees' claims under Section 4044.

## ARGUMENT

### I. PARTICIPANTS IN A CONTRIBUTORY DEFINED BENEFIT PLAN DO NOT HAVE A BENEFICIAL OWNERSHIP INTEREST IN THE PLAN'S SO-CALLED "SURPLUS."

The Ninth Circuit panel majority erroneously held that in a contributory defined benefit plan under ERISA, "employees are vested in their own contributions and the income generated therefrom." Pet. App. 21a. This is a wholly inaccurate description of a defined benefit plan, such as the Hughes Plan. In contrast to a defined *contribution* plan, in which the employee's pension benefit is determined by the contributions to the plan by him and on his behalf, as well as the earnings attributable to those contributions, the terms of a defined *benefit* plan spell out the benefits to be paid without reference to contributions or earnings on contributions. *See supra* p. 3; *see also Keystone Consol. Indus.*, 508 U.S. at 154; *Nachman*, 446 U.S. at 364 n.5.

The critical difference between defined contribution and defined benefit plans is who bears the risks and rewards of the investment of the funds. In a defined contribution plan, all risks and rewards fall on the employee-participant. In a defined benefit plan, the risks and rewards all fall on the employer: if the plan's investments fare poorly, the employer must still contribute whatever is required to deliver the promised benefit to the employee at retirement; conversely, favorable investment performance might lighten and even eliminate for varying periods of time the need for employer contributions.

That a defined benefit plan is also contributory does not turn the plan into a defined contribution program. As Judge Easterbrook has explained, workers who contribute to a defined benefit plan

purchase "a promise of benefits," not a share in "a pool of assets." *Johnson v. Georgia-Pac. Corp.*, 19 F.3d 1184, 1186 (7th Cir. 1994). The interest of an employee who contributes to a defined benefit plan is thus akin to the interest of a purchaser of a conventional annuity contract who buys a specified stream of payments. *Id.* It is not like owning shares in a mutual fund where the value of the interest depends on the fund's investment successes or failures.

Here, the Ninth Circuit panel majority confused these two concepts. It held that a contributory defined benefit plan is a sort of hybrid plan—in which an employee's contribution to the employer's pension plan entitles that employee upon retirement not only to a fixed, defined benefit, but also potentially to any investment return attributable to his or her contributions. In this hybrid, the employer bears all the risk and obligation of a defined benefit plan and the employee enjoys all the rewards, but none of the risk, of a defined contribution plan. Under the majority's view, the *defined* benefit becomes a *minimum* benefit.

Judge Norris in his dissent explained why this result flies in the face of economic reality:

> Pension law covers bad times as well as good times. In bad times (when declines in the value of assets make plans underfunded) employers must contribute more. If in good times employers were required to distribute the surplus to retirees on the theory that they "owned" that value, outcomes would be asymmetric. Employers would be liable for shortfalls but could reap no benefit from surpluses.

Pet App. at 29a, quoting from *Johnson*, 19 F.3d at 1190.

As demonstrated by the facts of this case, the implications of recognizing this new type of hybrid plan are severe. Whenever a defined benefit plan contains so-called "surplus," the employer



cannot amend the plan to add a new benefit or a new benefit structure applicable to a subset of plan participants (for example, current workers but not retirees). This is because the Ninth Circuit treats the so-called "surplus" attributable to employee contributions as a distinct asset in which plan participants enjoy something akin to an ownership interest that bestows upon plan sponsors a special fiduciary responsibility.

Repeatedly, this Court has held that ERISA's fiduciary provisions do not prevent an employer or other plan sponsor from adopting an amendment to its welfare or pension plans "for any reason at any time." *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78 (1995) (welfare plans); *Lockheed Corp. v. Spink*, 517 U.S. 882, 890-91 (1996) (pension plans). These cases firmly establish that an employer's amendment to its plan is the act of a "settlor" and not a "fiduciary" as defined by ERISA Section 3(21)(A), 29 U.S.C. § 1002(21)(A). *Curtiss-Wright*, 514 U.S. at 78; *Lockheed*, 517 U.S. at 890-91. Therefore, the obligation that fiduciaries discharge their duties "solely in the interests of participants and beneficiaries" and "for the exclusive purpose of providing benefits to participants and their beneficiaries" do not apply to an employer's amendment of its benefit plans. ERISA Section 404, 29 U.S.C. § 1104; *see Curtiss-Wright*, 514 U.S. at 78; *Lockheed*, 517 U.S. at 890-91.[5]

The Ninth Circuit's newly-created exception to that rule for plans with contributory features disregards what this Court in *Lockheed* called the statute's "simply stated" language, "general"

[5] Although the act of amending a pension plan to add benefits or beneficiaries falls outside ERISA's fiduciary provisions, other provisions of the statute operate to protect employees' interests. *See, e.g.*, ERISA Section 204(g), 29 U.S.C. § 1054(g) (plan amendments generally may not decrease accrued benefits); ERISA Section 307, 29 U.S.C. § 1085b (if adoption of an amendment results in underfunding of a defined benefit plan, the sponsor must post security for the amount of the deficiency). *See generally Lockheed*, 517 U.S. at 891.

terms, and "uniform" standards regarding fiduciaries—all of which, the Court held, required it to apply the same rules regarding fiduciary capacity to pension plans as are applied to welfare plans.

The Ninth Circuit's result rests not on the statute's definition of a "fiduciary" act,[6] but on two unrelated statutory provisions. App. 9a. Neither of these provisions is sufficient to alter the general rule that an employer that amends its plan to offer new benefits or a different benefit structure is acting as a settlor and not a fiduciary.

The first provision relied upon by the Ninth Circuit is the minimum vesting provisions of ERISA Sections 203 and 204, 29 U.S.C. §§ 1053, 1054 (1994). Under ERISA, an employee must acquire nonforfeitable rights in the accrued benefits derived from his or her employer's contributions to the plan according to the statute's prescribed vesting and accrual schedules. ERISA Section 203(a)(2) (vesting schedules), 29 U.S.C. § 1053(a)(2); Section 204(b)(1) (accrual schedules), 29 U.S.C. § 1054(b)(1). An employee's rights in the accrued benefits derived from his or her own contributions to the plan must always be nonforfeitable. ERISA Section 203(a)(1), 29 U.S.C. § 1053(a)(1).

In a defined contribution plan, the nonforfeitable "accrued benefit" attributable to an employee's contributions is equal to his or her contributions, any allocable forfeitures, and the income, expenses, gains, and losses attributable to the contributions and forfeitures. ERISA § 204(c)(2)(A)(i), 29 U.S.C. § 1054(c)(2)(A)(i). In a defined benefit plan, on the other hand, the "accrued benefit" attributable to an employee's mandatory

[6] The statute states that a person is a fiduciary with respect to a plan "to the extent" he or she "exercises any discretionary authority or . . . control respecting management of such plan or . . . its assets," "renders investment advice," or can exercise "discretionary authority or . . . responsibility in the administration of such plan." ERISA Section 3(21)(A), 29 U.S.C. § 1002(21)(A).



contributions is equal to the sum of the employee's contributions, plus interest at a rate prescribed by statute. ERISA § 204(c)(2)(C), (D), 29 U.S.C. § 1054(c)(2)(C), (D). That prescribed rate since 1987 is an interest rate equal to 120 percent of the federal mid-term rate in effect for the first month of a plan year. *Id.*

The panel majority held that if a plan is contributory, "employees are vested in their own contributions and the income generated therefrom." Pet. App. 21a. This is simply not true in the case of a defined benefit plan such as the Hughes Plan. As the statute makes clear, in a defined benefit plan, employees are vested only in an accrued benefit that is attributable to the contributions themselves plus specified levels of imputed annual interest. The amount of interest imputed to the employee contributions is fixed by law, and is wholly unrelated to the successes or the failures of the plan's investments.[7] Far from creating the broad ownership right the panel majority purports to find, that vested interest becomes a plan liability that reduces the plan's so-called surplus.

The second provision relied on by the panel, ERISA Section 4044(d)(3)(A), 29 U.S.C. § 1344(d)(3)(A), addresses asset allocation upon plan termination. Plan termination by an employer is governed exclusively by ERISA Section 4041, 29 U.S.C. § 1341. In order to terminate a plan, the plan administrator must file a notice with the Pension Benefit Guaranty Corporation (PBGC) and must wait, before taking further action, until the time for the PBGC to issue of notice of noncompliance has expired. 29 U.S.C. § 1341(a), (b). Assets must then be allocated to various types of benefit liabilities in order of priority pursuant to ERISA Section 4044(a), 29 U.S.C. § 1344(a).

[7] Respondent retirees do not allege in their complaint that the two amendments to the Hughes Plan resulted in a prohibited forfeiture of the defined benefit that they had been promised or that the amount of the benefit was less than the amount that had vested as a result of their contributions. Rather, they assert a right to all of the investment earnings attributable to their contributions. Pet. App. 139a-140a.

Where the assets are sufficient, the level of benefits to be paid following termination will be equal to what is specified in the plan. *See generally Mead Corp. v. Tilley*, 490 U.S. 714, 717 (1989). If there are "residual assets" left in the plan after all liabilities have been satisfied, ERISA Section 4044(d)(3)(A), 29 U.S.C. § 1344(d)(3)(A), provides that the residual assets attributable to employee contributions shall be distributed to the contributing employees. Residual assets not attributable to employee contributions may revert to the employer, if the plan so provides. ERISA Section 4044(d)(1), (2), 29 U.S.C. § 1344(d)(1), (2).

The Ninth Circuit bootstrapped the contingent remainder interest prescribed by Section 4044(d)(3)(A) into a general ownership or beneficial interest in plan "surplus" no matter whether any termination of the plan has occurred or is contemplated. *See* Pet. App. 9a. But a plan's so-called "surplus" is simply a means of describing the difference at any given moment between the value of the assets held by the plan and an actuarial estimate of the costs of paying future benefits. *See* Pet. App. 32a (Norris, J., dissenting) ("'surplus' in a pension fund is nothing more than an actuarial artifact"); *see also Johnson*, 19 F.3d at 1189 ("surplus . . . is an accounting construct"). Plan "surplus" can shrink or even be turned into a "deficit" for any number of reasons, including an unexpected increase in early retirements, retirees living longer than the actuaries predicted, plan earnings falling below actuarial assumptions, stock market corrections, and the hiring of many new employees who become participants in the plan.

A plan's "surplus" is never immutable except upon termination, after all liabilities have been identified, prioritized, and settled through the purchase of annuities. ERISA Section 4041(b)(3), 29 U.S.C. § 1341(b)(3). Then, and only then, can there be an accurate calculation of "surplus" capable of distribution to employees or reversion to the employer. This is why an employer-sponsor of a noncontributory plan whose plan is overfunded cannot, absent termination, reappropriate assets to itself simply because the fund has an actuarial "surplus." Similarly, employees who



participate in a contributory plan have no claim to the "surplus" theoretically attributable to their contributions unless and until the plan has terminated and all liabilities have been satisfied. *See Walsh v. Great Atlantic and Pacific Tea Co., Inc.*, 96 F.R.D. 632, 652 (D.N.J. 1983) ("As long as the remainder of the plan remains ongoing, 'excess assets' is a meaningless concept, since the amount of any surplus can only be calculated after a complete termination of the plan."), *aff'd*, 726 F. 2d 956 (3d Cir. 1983).

The existence of a "surplus" has no bearing on the benefits due to the participants in an ongoing pension plan. It no more entitles contributing employees to additional benefits than a plan "deficit" would support a reduction in their pensions.

By mistakenly treating plan "surplus" not as an actuarial construct but as a pool of assets akin to a mutual fund, the Ninth Circuit took two narrow ERISA provisions applicable only to quite specific circumstances and from them derived a broad abstract principle that "when both the employer and its employees contribute to a pension plan, the employer does not have sole discretion to use that part of a plan's asset surplus attributable to employee contributions." Pet. App. 21a. This is a leap in logic that simply is not supported by the statutory scheme. Even less supportable is the court's second leap—that an employer that amends a contributory plan to add new or different benefits at a time when a plan "surplus" exists is necessarily acting in a fiduciary capacity. Pet. App. 16a. This second leap is made without any reference to the statutory definition of a fiduciary.[8]

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[8] The panel majority noted that "because Hughes was disposing of the plan's assets when it amended the plan, Hughes's amendment necessarily affected the management and administration of the plan." Pet. App. 16a. This nod to the statutory definition of "fiduciary" is wholly unpersuasive. It would encompass virtually *all* plan amendments. This Court has made clear that an employer acting to amend its plan is not "managing" or "administering" assets within ERISA's definition of fiduciary. *Lockheed*, 517 U.S. at 890; *Varity Corp. v. Howe*, 516 U.S. 489, 505 (1996).

Finally, in addition to having no grounding in the statute, the decision below is completely unworkable. An employer that wanted to amend a plan to offer new or different benefits to some but not all plan participants—such as active but not retired employees, older but not younger employees, employees in one location but not another—could not do so if the plan at that point in time had a "surplus," for the "surplus" would always include some assets theoretically attributable to contributions made by the excluded employees. The employer would either have to offer the new benefits to all—which might defeat the purpose of offering them in the first place—or wait until plan "surplus" was eroded, a process that might take many years (or that might never occur) if the plan enjoyed a high return on its investments.

Not surprisingly, neither the respondents nor the court below can point to anything in ERISA suggesting that Congress wished to put a freeze on amendments to contributory defined benefit plans (or plans that had once been contributory) whenever the plan enjoyed investment success beyond its actuarial estimates. Indeed, such a result would severely restrict benefit plan "design"—a subject that Congress unquestionably left to employer discretion. *See, e.g., Lockheed*, 517 U.S. 890-91; *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 511 (1981).

## II. THE TERMINATION OF A PLAN IS A QUESTION OF LAW GOVERNED SOLELY BY ERISA, NOT A QUESTION OF FACT.

The panel majority also erred in holding that the trial court could find as a matter of fact that Hughes' 1991 Plan amendment caused a "termination" of the Plan, triggering Section 4044's required allocation of plan assets. *See* Pet. App. 10a-12a, 22a-23a. Plan termination is a wholly legal question, governed by a highly detailed and specific statutory scheme.

Plan termination is a topic that Congress has addressed in painstaking detail in Title IV of ERISA. *See* ERISA Sections 4041-



48, 29 U.S.C. §§ 1341-48. Section 4041(a)(1), the key termination provision in this highly detailed regulatory scheme, is entitled "*Exclusive* means of plan termination" (emphasis added) and provides:

> Except in the case of a termination for which proceedings are otherwise instituted by the [Pension Benefit Guaranty C]orporation as provided in section 4042 of this title, a single-employer plan may be terminated only in a standard termination under subsection (b) of this section or a distress termination under subsection (c) of this section.

ERISA Section 4041(a)(1), 29 U.S.C. § 1341(a)(1).

Section 4041 goes on to provide that, in order to terminate a plan, the plan administrator must file a notice with the PBGC and must wait, before taking further action, until the time for the PBGC to issue of notice of noncompliance has expired. ERISA Section 4041(b)(2)(C), 29 U.S.C. § 1341(b)(2)(C). Assets must then be allocated to various types of benefit liabilities in order of priority pursuant to ERISA Section 4044, 29 U.S.C. § 1344(a). To the extent that assets are sufficient to cover liabilities under a plan, the administrator of a terminating plan is directed to "fully provide all benefit liabilities under the plan." 29 U.S.C. § 1341(b)(3)(A)(ii). This usually involves purchasing annuities from an insurer. 29 U.S.C. § 1341(b)(3)(A)(i). Only after all liabilities have been satisfied does the statute address the issue of distribution of residual assets, if any. *See* Section 4044(d), 29 U.S.C. § 1344(d).

Ignoring all but that part of the statute relating to distribution of residual assets, the panel majority held that Hughes may have "in effect, terminated" the plan or that its conduct may have amounted to a "constructive" termination of the plan, Pet. App. at 10a, 11a n.3. As the panel majority saw it, whether amending a retirement plan to add a new benefit formula amounts to "constructive" termination is a factual issue to be resolved only after discovery. *See id.* at 11a n.3, 22a-23a.

The majority opinion is notably lacking in citation to statutory or case law authority for its holding, but there are indications that it may have been misled by certain tax and trust law concepts inapplicable to ERISA Title IV. First, under the Internal Revenue Code, in order to "qualify" for preferential tax treatment, a plan must provide that accrued benefits become nonforfeitable, to the extent then funded, upon complete or partial termination of the plan (even if those benefits would not otherwise have vested). *See* 26 U.S.C. § 411(d)(3). The purpose of this provision is to protect employees by ensuring that they cannot be deprived of anticipated benefits through an employer's elimination of the opportunity to have those accrued benefits vest. *See United Steelworkers v. Harris & Sons Steel Co.*, 706 F.2d 1289, 1298 (3d Cir. 1983); *Amato v. Western Union Int'l, Inc.*, 773 F.2d 1402 (2d Cir. 1985), *cert. denied*, 474 U.S. 1113 (1986).

The Treasury regulation implementing Code Section 411(d)(3) defines a plan "termination" that can lead to vesting of accrued benefits as either one in which the plan has been involuntarily terminated by the PBGC or one in which the employer has voluntarily terminated the plan under the procedures set forth in ERISA Section 4041. *See* 26 C.F.R. § 1.411(d)-2(c). In contrast, a "partial termination" for purposes of vesting under Section 411(d)(3) is determined by "all the facts and circumstances" in a particular case, and might include a large reduction in the work force or a sizable reduction in benefits under the plan, such that a significant percentage of employees have lost the opportunity to have accrued benefits vest. *See* 26 C.F.R. § 1.411(d)-2(b)(1).[9]

The tax-law notion of "termination" is completely irrelevant here because respondents have made no claim that certain accrued benefits under the plan should have become nonforfeitable at the time of the 1991 amendment. In any event, even the Treasury

[9] The regulation cited by the Ninth Circuit, 26 C.F.R. § 1.401-6(b)(i), predates ERISA. *See* 11a n.3., 49a, 52a.



regulation recognizes that a voluntary termination can take place *only* under the procedures set forth in ERISA Section 4041. *See* 26 C.F.R. § 1.411(d)-2(c).[10]

The court's suggestion that the District Court could find that the Hughes Plan may have terminated as a "wasting trust"—*i.e.*, one that pays only previously accrued benefits—likewise misperceives the exclusive role of Section 4041 in plan terminations. Pet. App. 11a n.3. Although wasting trusts were at one point an allowable means of terminating a trust under Section 4041, they were eventually prohibited by PBGC regulations, *see* 29 C.F.R. § 2617.4(a) (1984), and that prohibition is now embedded in statute. *See* ERISA § 4041(b)(3)(A), as amended by Single-Employer Pension Plan Amendments Act of 1986. Plan terminations may now occur only through the purchase of annuities in satisfaction of benefit liabilities. *Id., see generally* Edward T. Veal and Edward R. Mackiewicz, Pension Plan Terminations § 6.1 (1989 & Supp.). Unquestionably that is not what happened here.

By importing irrelevant tax and common law trust concepts into ERISA Title IV, the Ninth Circuit casts doubt on a plan amendment that appears to be no different from the type of plan amendment that thousands of employers routinely have adopted to alter, and typically to improve, plan benefits for participants.

[10] The concept of a "partial termination" is peculiar to the tax code and concerns only whether certain accrued benefits must become nonforfeitable. It does not constitute a termination for purposes of allocation of assets under Title IV of ERISA. *See, e.g.*, ERISA Section 4043(c)(4), 29 U.S.C. § 1343(c)(4)(1994); *Chiles v. Ceridian Corp.*, 95 F.3d 1505, 1516 (10th Cir. 1996); *Borst v. Chevron*, 36 F.3d 1308, 1315 (5th Cir. 1994); *Chait v. Bernstein*, 835 F.2d 1017, 1020-21 (3d Cir. 1987); *United Steelworkers of America v. Harris & Sons Steel Co.*, 706 F.2d 1289, 1299 (3d Cir. 1983); *Baum v. Nolan*, 853 F.2d 1071, 1076-77 (2d Cir. 1988), *cert. denied*, 489 U.S. 1053 (1989).

There appears to be no dispute that many active Hughes employees elected to continue making contributions in order to qualify for the older and more generous benefit formula. There are only conclusory allegations that "in effect" two plans were created and that the amendment was "equivalent" to a termination. Such allegations are simply artful pleading tactics designed to portray a legal claim as a factual issue.

Employers commonly improve pension benefits for their employees by adding an additional benefit formula to the plan. In many cases, benefits are calculated separately for each employee under the several formulas in the plan, with the employee receiving benefits under the formula that produces the largest benefit. But it is also a common practice, as was done here, to extend to new or future employees only a newly adopted benefit formula. If employers must run the risk on a case-by-case basis of having a court find as a factual matter that the adoption of a new benefit formula somehow terminates a plan, possibly with very serious adverse tax consequences for both the employer and its employees, a very substantial and quite unnecessary obstacle will be placed in the path of improved employee benefits.

The court of appeals' suggestion that when a plan amendment limits a pre-existing benefit formula to current participants but adopts a new formula for future participants, the amendment may amount to a "constructive termination" of the plan, *see* Pet. App. 11a n.3, has very troubling implications that extend well beyond the immediate context of contributory defined benefit plans. The notion that "freezing" or limiting an existing benefit formula to current participants is a "constructive" termination could mean, for example, that the Pension Benefit Guaranty Corporation would be required to assume many billions of dollars in additional termination liabilities for underfunded plans. *Cf. United Steelworkers of America v. Harris & Sons Steel Co.*, 706 F.2d 1289 (3d Cir. 1983).

For all these reasons, it was error for the Ninth Circuit to hold that the Hughes Plan could "in effect" have terminated without



complying with the procedures prescribed by Section 4041. That section "provide[s] the sole and exclusive means under which a qualified pension plan may be terminated." H.R. Rep. No. 300, 99th Cong., 2d Sess. 289 (1985). *See In re Esco Manufacturing Co.*, 50 F.3d 315, 316 (5th Cir. 1995); *American Flint Glass Workers Union v. Beaumont Glass Co.*, 62 F.3d 574 (3d Cir. 1995); *Phillips v. Bebber*, 914 F.2d 31, 34 (4th Cir. 1990). There having been no allegation that the Hughes Plan terminated under Section 4041, it was error for the Ninth Circuit to remand for further proceedings on the question of whether a termination had occurred. The district court rightly dismissed that claim as a matter of law.

## CONCLUSION

For the foregoing reasons, this Court should reverse the decision below.

Respectfully submitted,

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